

Date of Hearing: March 28, 2017

ASSEMBLY COMMITTEE ON JOBS, ECONOMIC DEVELOPMENT, AND THE ECONOMY

Sharon Quirk-Silva, Chair

AB 961 (Quirk-Silva) – As Amended March 21, 2017

SUBJECT: Disabled Veteran Business Enterprise Program

SUMMARY: Tightens the existing monitoring and accountability requirements for state procurement activities related to the disabled veteran business enterprise (DVBE) targeted procurement program.

Specifically, **this bill:**

- 1) Adds specificity to the type of monitoring the Department of Veteran Affairs (CALVET) is required to maintain relative to its outreach and promotional activities, including creating a list that identifies the name, location, number, and type of business, by size and industry sector, attending or participating in a promotional effort.
- 2) Deletes a requirement for a periodic survey of newly certified DVBEs to determine how they learned about the program and why they became certified and, instead, requires the CALVET to annually compare the list of attendees at promotional events from the current and prior two years with the list of newly certified DVBEs and the list and/or participates in a state contract, as specified.
- 3) Provides that the annual comparison of attendees at promotional events to certified DVBEs and DVBE contract participation is to be one of the performance measures used to evaluate the success of the promotional efforts.
- 4) Requires awarding departments to retain DVBE payment records for five-years. These records are already mandated to be submitted by prime contractors who have committed to using DVBE subcontractors. The awarding department is also required to establish a process to confirm that these records are submitted, accurate, and reflect the agreement set forth in the state contract.

EXISTING LAW:

- 1) Establishes the California Disabled Veteran Business Enterprise Program, administered by Department of General Services (DGS), for the purpose of addressing the special needs of disabled veterans seeking rehabilitation and training through entrepreneurship, and to recognize the sacrifices California's disabled veterans made during their military service. Contracts for professional bond services are administered through the State Treasurer's Office.
- 2) Applies the 3% DVBE participation goal on each awarding state agency, department, and officer that enters into a contract for materials, supplies, equipment, alteration, repair, or improvement. This requirement can be waived on a specific contract with the approval of the department director or another designated person. Contracts with a DVBE for equipment rentals do not count toward the goal.
- 3) Defines the following terms:
 - a) A DVBE contractor, subcontractor, or supplier is any person or entity that has been certified by the administering agency and that performs a commercially useful function, as defined.

- b) A disabled veteran is a veteran of the military, naval, or air service of the U.S. who has a service-connected disability of at least 10% and who is domiciled in the state.
- c) A DVBE is a business certified by the administering agency as meeting all of the following requirements:
 - i) The legal structure of the business is a:
 - (1) Sole proprietorship with at least 51% owned by one or more disabled veterans;
 - (2) Publicly owned business with at least 51% of its stock unconditionally owned by one or more disabled veterans;
 - (3) Subsidiary that is wholly owned by a parent corporation, but only if at least 51% of the voting stock of the parent corporation is unconditionally owned by one or more disabled veterans; or
 - (4) Joint venture in which at least 51% of the joint venture's management, control, and earnings are held by one or more disabled veterans.
 - ii) The management and control of the daily business operations are by one or more disabled veterans. The disabled veterans who exercise management and control are not required to be the same disabled veterans as the owners of the business.
 - iii) It has a home office located in the United States, which is not a branch or subsidiary of a foreign corporation, foreign firm, or other foreign-based business.
- 4) Requires DGS to collect information from awarding departments on the level of DVBE procurement participation. The current report lists total contract values awarded and amount expected to be paid to DVBE contractors.
- 5) Requires an awarding state department to require a prime contractor who has committed to using a DVBE subcontractor to certify upon completion of the contract:
 - a) The total amount the prime contractor received under the contract.
 - b) The name and address of the DVBE that participated in the performance of the contract.
 - c) The amount each DVBE subcontractor received from the prime contractor.
 - d) That all required payments under the state contract have been made to the DVBE subcontractor.
- 6) Provides that a person or entity that knowingly provides false information on the DVBE subcontractor certification shall be subject to a civil penalty for each violation in the minimum amount of \$2,500 and the maximum amount of \$25,000.

FISCAL EFFECT: Unknown

POLICY FRAMEWORK:

This bill implements changes to the DVBE Program in response to the 2014 State Auditor Report which found, among other things, that current tracking and reporting of promotional activities were insufficient and that departments failed to maintain appropriate record keeping protocols on contracts involving DVBEs.

The analysis includes background on the Small Business Procurement and Contract Act, current DVBE Program activity, previous legislative efforts to improve program accountability, and recommendations from the 2014 State Audit.

COMMENTS:

- 1) **Small Business Procurement and Contract Act:** The Small Business Procurement and Contract Act (Small Business Procurement Act), administered through DGS, was implemented more than 30 years ago to establish a small business preference within the state's procurement process that would increase the number of contracts between the state and small businesses. A DBVE component was added in 1989.

The Small Business Procurement Act states that it is the policy of the State of California that the state aid the interests of small businesses in order to preserve free competitive enterprise and to ensure that a fair portion of the total purchases and contracts of the state be placed with these enterprises. The statute further states that DVBE participation is strongly encouraged to address the special needs of disabled veterans seeking rehabilitation and training through entrepreneurship, and to recognize the sacrifices of California's disabled military veterans. Statute sets an annual 3% DVBE participation goal, and a 25% goal is set through executive order for small businesses and microbusinesses.

A majority of DVBEs are smaller size firms with 75.4% having a dual certification as a DVBE and microbusiness and 9.6% having a dual DVBE and small business certification. The remaining 15% of DVBEs operate with only a single DVBE certification.

- 4) **The DVBE Program:** The 3% DVBE procurement participation goal is applied to the state agency or department's overall contracting activities in the given fiscal year and may be achieved by awarding state contracts to DVBEs as prime contractors or when DVBEs are used as a subcontractor.

Awarding departments have an option of including DVBE participation in every contract or making alternative arrangements, as long as the 3% objective is met at the end of the year. Each agency and department is required to designate a small business and DVBE contracting liaison to facilitate it in meeting the 3% DVBE goal and the 25% small business goal.

Departments also have the option of offering a 1% to 5% DVBE contracting preference to encourage bidders use DVBE subcontractors. Although not currently being utilized, bidders that are unable or unwilling to include a DVBE in a contract also have the option of submitting a DGS approved utilization plan, that commits the businesses to using DVBEs in the future. DGS is authorized to audit businesses that submit utilization plans to ensure compliance.

State departments that fail to meet the annual 3% goal can have their delegated contracting authority removed, although DGS has never removed program authority solely based on an agency or department's failure to meet its DVBE contracting goal.

DGS' has a range of responsibilities relating to the implementation of the DVBE Program including:

- Certification of DVBEs (2,043 DVBEs certified in 2015-16);
- Certification of small businesses and microbusinesses (25,824 small businesses and microbusinesses certified in 2015-16);
- Outreach to the potential bidders and the veteran community (191 events in FY 2015-16);
- Marketing of the DVBE program to state agencies;
- Partnering with CalVet on meetings with departments that are not meeting participation goals.

- Consulting with the California Procurement Contracting Academy on the DVBE training of state contracting staff;
- Preparation of an annual consolidated report on DVBE, small business, and microbusinesses participation within state contracting activities; and
- Program oversight to identify abuses by bidders and failures to perform by state agencies.

Below are charts displaying five years of DVBE participation rates. The charts include information on mandatory reporting entities and all reporting entities. Under both reporting metrics, it appears that the state is consistently meeting its DVBE procurement participation goals.

DVBE Five-Year Contracting Activity – Mandated Agencies (in millions)				
Fiscal Year	Total Contract Dollars	Total DVBE Dollars	Total DVBE Percent	Total DVBE Contracts
2015-16	\$5,855	\$274	4.67%	18,638
2014-15	\$8,105	\$314	3.8%	16,192
2013-14	\$6,566	\$241	3.67%	12,777
2012-13	\$7,151	\$216	3.03%	14,907
2011-12	\$7,173	\$340	4.74%	16,246
Average	\$6970	\$277	4.00%	15,752

DGS Consolidated Reports for the contracting periods

DVBE Five-Year Contracting Activity – All Reporting Agencies (in millions)				
Fiscal Year	Total Contract Dollars	Total DVBE Dollars	Total DVBE Percent	Total DVBE Contracts
2015-16	8,090	\$349	4.41%	21,739
2014-15	\$10,073	\$407	4.7%	18,228
2013-14	\$8,233	\$299	3.64%	14,305
2012-13	\$8,573	\$267	3.12%	16,776
2011-12	\$8,508	\$373	4.39%	17,835
Average	\$8695	\$339	3.92%	17,776

DGS Consolidated Reports for the contracting periods

While the year-to-year percentages are useful to review, it is also important to note that consistency among which agencies report or even which agencies believe that they are mandated to report varies. As an example, in 2011-12 86% of the mandatory reporting entities reported their contracting activity to DGS. In 2012-13, 79% reported their contracting activity and in 2015-16, 80% reported.

- 5) **Concerns with DVBE Program:** While DVBE participation rates have reported to have been met in each of the past seven years, programmatic challenges continue to plague the program. Among other things, significant issues have been raised relative to the accuracy of the reporting data and on fraudulent bidder practices. The Committee has repeatedly heard from veteran groups about bidders that fail to follow-through on the DVBE commitments made in bid proposals, bidders that include DVBEs that haven't renewed their certification, and of DVBEs being included within bid proposals, but never actually performing a commercially useful function.

Some of these program concerns have been addressed in legislation which increased penalties, defined commercially useful function, and strengthened bidder reporting requirements, including AB 177 (Ruskin and V. Manuel Pérez) Chapter 342, Statutes of 2010 and SB 1510 (Wright), Chapter 421, Statutes of 2012, respectively. A more comprehensive list of compliance enhancements is included under the related bills section of the analysis.

Concerns over inconsistent reporting by contracting agencies, lack of enforcement tools to keep poor performing DVBEs from obtaining new awards, and challenges to increasing the number of certified DVBEs that participate in state contracting activities have not been comprehensively addressed in more than a decade. Responding to these and other issues, Senator Hueso, then Chair of the Senate Committee on Veterans Affairs, and former Senator Ron Calderon, requested that the Joint Legislative Audit Committee approve a comprehensive review of the DVBE program by the California State Auditor.

As part of the State auditor's 2013-2014 review, five awarding departments were visited in order to evaluate the documentation used to support their reported DVBE participation data. According to the Auditor, *"All five departments could not fully support the amounts reported, and four of the five had significant errors. In some cases, departments failed to maintain supporting records or manually counted their DVBE data incorrectly, such as double-counting DVBE contracts or taking credit for working with firms who were not DVBEs. The departments we visited also used different methodologies for reporting their DVBE data, thus limiting the public's ability to compare the performance of different awarding departments."*

Among other findings, the State Auditor found the following:

- a) The State's current method of measuring the success of the DVBE program may distort an assessment of whether the program is meeting the legislative intent to increase DVBE participation in state procurement. By measuring and reporting the amount the state awards, rather than pays to DVBE likely means that a lesser amount of state funds actually go to DVBEs.
- b) The data in the State Contract and Procurement Registration System indicates that only a relatively small subset of DVBE firms enjoy the major part of the State's business—during fiscal year 2012–13, 83% of the DVBE prime contract award amounts went to only 30 DVBE firms. *No similar assessment was made regarding subprime contractors.*
- c) There is inadequate documentation by state contracting agencies on DVBE participation.
- d) Reporting methodologies differ by state agencies on DVBE participation.
- e) DGS has not provided clear guidance as to what level of support and documentation is sufficient to support their reported DVBE performance data nor how to report DVBE participation on multiyear contracts. *Since the audit, DGS has modified training documents to clarify many of the issues raised in the audit.*
- f) CalVet's management confirmed that it has not taken an active role in coordinating with awarding departments to promote DVBE contracting opportunities.

Based on these findings, the Auditor's recommendations focused on taking actions to increase the overall number of different DVBEs that participate in state contracting, as well as more consistent reporting and documentation including a heightened role and accountability for CalVet.

The Senate and the Assembly policy committees worked together to address many of these issues, sponsoring legislation in 2014 [SB 839 (Correa) and AB 1735 (Jones-Sawyer)] and in 2015 [AB 1218 (Weber)]. All bills were held in Appropriations Committees due to costs. AB 1218, as an example,

was reported to have \$2 million in reprogramming costs associated with the ongoing development of FISCAL.

Unsuccessful legislative proposals have not necessarily deterred DGS from moving forward on its own to address a number of issues in the 2014 audit, including modifications to training materials in order to clarify reporting issues raised in the audit and expanded outreach to state agencies that fail to meet targeted procurement participation goals. In 2015-16, DGS, in collaboration with the CALVET, met with 13 departments that did not achieve one or both of their goals, including:

- High spend state entities with over \$20 million in annual contracting: California High Speed Rail Authority; California Public Utilities Commission, and the Office of Systems Integration.
- Small and medium-spend state entities with under \$20 million in annual contracts: Agricultural Labor Relations Board; California Housing Finance Agency; California Arts Council; California Human Resources/State Personnel Board; California Science Center; Delta Stewardship Council; Department of Managed Health Care; Governor's Office of Business and Economic Development; Office of Environmental Health Hazard Assessment; and the California Coastal Conservancy.

To address the concern that state contracts were being awarded to only a small number of DVBEs, DGS has committed to more closely overseeing the recording of payments to DVBE subs and the buildout of a public database that will allow people to search and review DVBE contract participation.

The changes proposed in AB 961 support and supplement that activities of DGS and CALVET, but are intended to not require reprogramming of FISCAL or other costly new activities. AB 961 focuses on better record keeping and outcome monitoring of promotional activities.

6) Related Legislation: Below is a list of related measures.

- a) *AB 177 (Ruskin and V. Manuel Pérez) Enforcement of Small Business Act*: This bill increases and conforms penalties for persons who falsely engage in activities relating to the Small Business Procurement and Contract Act, including small businesses, microbusinesses, and disabled veteran-owned business enterprises. Status: The bill was signed by the Governor, Chapter 342, Statutes of 2010.
- b) *AB 1218 (Weber) Disabled Veteran Business Enterprise Public Contracts*: This bill would have harmonized the statutory provisions of the currently mandated 3% goal for contracting with disabled veteran-owned business enterprises (DVBE) and the related reporting requirements. This bill would have also addressed other program deficiencies, as identified by a 2014 audit of the DVBE Program. Status: Held on the Suspense File of the Senate Committee on Appropriations, 2015.
- c) *AB 2249 (Ruskin) DVBE Documentation*: This bill requires applicants for small business or DVBE certification to submit a written declaration, under penalty of perjury, that the information submitted to DGS is true and correct. The bill also authorizes DGS, if it determines that just cause exists, to require the owner of a DVBE or small business to submit the Internal Revenue Service Form 4506-T which would allow DGS to obtain a copy of their tax return. Finally, the bill requires that at least 51% of the stock or voting stock of a disabled veteran business enterprise be

unconditionally owned by disabled veterans. Status: Signed by the Governor, Chapter 383, Statutes of 2010.

- d) *AB 2682 (Wagner) Responsible Small Business and DVBE Contractors*: This bill would have required a state agency that solicits offers, awards a contract, or consents to subcontracts, under the Small Business Procurement and Contract Act, to do so only with responsible and reliable parties. Prohibits a state agency from allowing a party to participate in any procurement activity if the party has been suspended, debarred, or otherwise excluded from participation in a state contract. Status: Died in the Assembly Committee on Accountability and Administrative Review, 2014.
 - e) *SB 159 (Nielsen) Disabled Veteran Business Enterprise*: This bill would have clarified the metrics used when calculating the 3% procurement participation goal for disabled veteran business enterprises. The bill includes legislative findings that these changes are declaratory of existing law. The bill also includes chaptering provisions in the case that this measure and SB 1219 are both enacted. Status: Moved to the Assembly Inactive File without further action, 2016.
 - f) *SB 839 (Correa) Contracting with Veterans*: This bill would have modified reporting requirements for state departments with respect to DVBEs including contracts where the DVBE acted as the prime and as a subcontractor. Status: Held on the Suspense File in the Senate Committee on Appropriations, 2014.
 - g) *SB 941 (Florez) DVBE Advocates*: This bill requires the Department of Veteran's Affairs and awarding departments to appoint DVBE advocates to assist in meeting DVBE procurement participation goals. Status: Signed by the Governor, Chapter 666, Statutes of 2002.
 - h) *SB 1510 (Wright) Commercial Useful Purpose*: This bill tightens the bidder requirements for demonstrating that a small business, microbusiness, or DVBE will serve a commercially useful function (CUF) in carrying out a state contract. The purpose of the CUF requirement is to prevent a bidder from using a business as a "pass through" or "front" for another business that would otherwise not qualify for the small business, microbusiness or DVBE bid preference. By meeting the CUF requirements, a bidder may claim a bid preference on competitive state contracts for goods, services, informational technology, and public works. Status: The bill was signed by the Governor, Chapter 421, Statutes of 2012.
- 7) **Double Referral**: The Assembly Rules Committee has referred this to measure the Assembly Committee on Jobs, Economic Development and the Economy and to the Assembly Committee on Accountability and Administrative Review (AAR). Should this measure pass the committee, it will be referred to AAR for further policy consideration.

REGISTERED SUPPORT / OPPOSITION:

Support

None on File

Opposition

None on File

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